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JAMES H. McKENN
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SUPREME COURT OF THE UNITED STATES.

ALBERT K. HISCOCK, as Trustee in Bankruptcy of JACOB M. MERTENS, *et al.*, Bankrupts,
Appellant,

against

THE VARICK BANK OF NEW YORK,
Appellee.

Brief and Argument for Appellant on Motion to Dismiss.

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Appellant,

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THE VARICK BANK OF NEW YORK,

Appellee.

Brief for Appellant on Motion to Dismiss Appeal.

This is a motion by the appellee to dismiss the appeal or to affirm the judgment appealed from on the ground that the appeal is taken for delay only and is frivolous. The motion is not made upon any grounds claiming lack of jurisdiction.

FACTS.

The appeal is taken from a decree of the United States Circuit Court of Appeals for the Second Circuit, allow-

ing two claims filed by the Varick Bank against the bankrupts' estates, one claim having been allowed against the individual estate of J. M. Mertens in the amount of $9118.37, and the other claim having been allowed against the co-partnership estate of J. M. Mertens & Co. in the amount of $27,564.47, both being respectively the full amounts claimed by the Varick Bank. This decree of the Circuit Court of Appeals reversed the two tribunals which had previously passed upon the question at issue, namely, the Referee in Bankruptcy and the United States District Judge, both of whom held with the trustee.

On August 18, 1903, an involuntary petition in bankruptcy against J. M. Mertens & Company, a partnership, and against the individual members of that firm, composed of Jacob M. Mertens and his sons, was filed, and immediately thereafter the present trustee was appointed receiver of their estates and qualified as such. On September 15, 1903, an adjudication in bankruptcy was made against said partnership and said individuals. (p. 48.) At the time of the filing of the petition the Varick Bank, appellee, held a few customers' notes which Mertens & Company had discounted with it, amounting to about $5,000, and not very material to this discussion; but said Bank also held five notes, aggregating $22,500, all of which were for $5,000 each and were made by J. M. Mertens & Co., except one for $2500 on which Jacob M. Mertens, individually, was also maker. All of these notes were guaranteed (not endorsed in the legal sense) by J. M. Mertens & Co. and J. M. Mertens,

in a guaranty which appears on the back of each note. (pp. 49, 50.)

The Varick Bank also held two policies of life insurance in the Equitable Life Assurance Society of New York, both insuring the life of Jacob M. Mertens, one being in the amount of $50,000 and the other in the amount of $10,000. These were held by virtue of two assignments, which it will be noted contained no power of sale whatever.(p. 50.) They were also held by the Varick Bank under the terms of the said five notes, aggregating $22,500, each of which also contained on the face thereof (Fols. 7 and 8) an assignment of the policies in question with power of sale. All of these notes were on the same printed form. (p. 48.) At the time of the filing of the petition, the Varick Bank also held $6,000 in cash, which was on deposit to the individual account of J. M. Mertens. (p. 59.)

On September 14, 1903, while the receivership was still pending, the day before the adjudication was made, the Varick Bank (see stipulations, p. 63) without notice to anyone (3rd stipulation, Fol. 112) delivered these policies to its attorney, solicitor for the appellee in this case, and at the time of delivering the policies to its said attorney, and prior to said sale, said bank also gave to him its check which he cashed in bills to the amount of $10,250 (6th stipulation, p. 63.) The attorney then went to the New York Real Estate Sales Rooms and the policies were handed to an auctioneer there, where they were struck off on the bid of said attorney, it being the

only bid made and, as above said, no notice to anyone having been given, for the exact amount, $10,250, which said bank had given said attorney prior to the sale when it delivered to him the policies. The attorney bought them in the name of one Delanoie, no one else knowing of the sale and no one bidding except said attorney, although at this time the bank had actual notice of the receivership. It was conceded that Delanoie took the policies for the bank, that he still holds them for the bank; that immediately thereafter Delanoie pledged them to the Knickerbocker Trust Company for a loan of $10,250, the money from which was paid to the bank, and that subsequently he pledged them for a further loan from said Trust Company of $2,622.75. (pp. 63, 64.)

After this transaction the Varick Bank waited one year, lacking five days, from the adjudication (it will be remembered that claims not filed within one year after adjudication outlaw). During this time it did nothing, but on September 10, 1904, (the proofs of claim are not verified until September 9, 1904), it appeared in the Bankruptcy Court and filed the two proofs of claim, one as a secured claim against the individual estate for $9118.37, being the amount of the notes, less the $6,000 on deposit and also less the $10,250, the amount claimed to have been realized from the policies under the pretended sale; and said bank also filed another claim against the partnership as an unsecured claim for $27,564.47, although it will be carefully observed that the notes upon which the partnership claim is based are the

identical notes and indebtedness upon which the claim against J. M. Mertens individually is based. That partnership claim was consequently for the full amount of the notes, the Varick Bank claiming that it was not obliged to credit thereon the moneys which it had received from the deposit of $6,000 and from the pretended sale of the policies, amounting to $10,250. At the first subsequent meeting of creditors, when, these claims came up for the first time, the Trustee filed objections to each (Fols. 27 and 31), the substance of these objections being: 1. That the pretended sale was not a proper sale or any liquidation of the securities, and that the bank still held said policies as a pledge, the title thereto still remaining in the trustee. 2. That the indebtedness set forth in the claims had been partially paid, and that the debtors were not indebted in the amounts claimed, *i. e.*, that the full value of the policies must be realized and applied in payment. 3. That the sums realized from the policies and from off-setting the $6000 deposit should be credited also upon the partnership claim.

After the filing of these objections, the bank asked leave to file amended proofs of claim which was not done until December 1, 1904, (Fols. 34 and 35), and on the same day that the amended proofs of claim were filed the Trustee consented to proceed and did proceed with a hearing upon the issues (Fol. 35), which hearing was finished the following day.

At this hearing the claimant bank offered in evidence its proofs of claim and submitted sixteen stipulations of fact, all being done by the claimant voluntarily without

any contention that the burden of proceeding in the first instance was upon the trustee, no such contention being made until after the trustee had moved upon said stipulations of fact to disallow the claims (pp. 20, 21).

After these facts were in and *which are the very facts which show that the sale was a sham sale,* the bank asked the Court to allow the claims as filed and the trustee moved for a disallowance without resting his case or in any wise asserting that if the motion were not granted the trustee had finished his evidence (Fol. 38); and the Referee then made his decision (Fol. 39) in which he held that the pretended sale of the policies was sham and that their value had not been liquidated or ascertained, and that the bank, before it was entitled to any relief from this Court "should satisfy this Court that the full "value of the security held by it has been credited or will "be upon the total amount of its claims to which the same "applies." The Referee further said: "As the claim "against the co-partnership includes the notes set out in "the claim against J. M. Mertens individually, *I will "reserve the question as to the allowance against the co-"partnership for a subsequent determination."* The Referee then went on and expressly gave the bank the right to offer further evidence (bottom page 21) establishing the value of the policies and said, "You may pro-"ceed with any further evidence upon the subject without "prejudice to your right to review this decision *as a pre-"liminary question".*

It will be carefully noted that the Referee conse-

quently did not finally reject the claim of the bank as against the individual estate and that he did not pass at all upon the claim against the partnership estate. Also that *the Trustee did not rest his case* or in any wise take a position which would preclude him from the right to offer evidence himself upon the questions at issue, provided that the Referee had not decided the motion (Fols. 38 and 39) in his favor.

After this ruling by the Referee the trustee made a motion under Section 57-h of the Bankruptcy Act that the Court direct a method for liquidating the security by ordering the policies resold upon notice to the Trustee. The appellee asserts in its brief that the order made on this motion was an *ex parte* order. The record shows, however, (Fol. 41) that it was made in the counsel's presence; that he objected to the motion and specified his objections and that the Referee then reserved his decision until the bank should determine whether it would review the same. Subsequently the Referee having heard that the bank was to review his decision above mentioned, granted the motion made by the Trustee and directed that the liquidation be made by reselling the policies on notice to the trustee.

It will be noted that the Varick Bank did not appeal from this order made December 19th (Fol. 41) directing a resale of the policies on notice, but only appealed from the order made on December 2nd (Fols. 50 and 53).

On the petition for review, the case was heard before Hon. George W. Ray, District Judge, and he affirmed the

order of the Referee, in his opinion at page 23, still giving the appellee, however, the right to introduce further evidence; that is, it was still only a preliminary question (Fol. 51). The order of affirmance was made on January 21, 1905, and the bank then appealed to the Circuit Court of Appeals. Over a year had elapsed before the case was decided by the Circuit Court of Appeals on February 23, 1906, the latter Court reversing the two other tribunals (Fol. 78), and holding that the rulings of the Referee were final rejections of the claims (Fol. 79), and directing *that the claims be allowed in full.*

The findings of the Circuit Court of Appeals were not made until March 22, 1906, (Fols. 117 and 118) and on that very day the appeal to this court was perfected and allowed by Judge Wallace, presiding justice, and the one who wrote the opinion of reversal. The appellant at once filed the return on April 2, 1906, in this Court (Fol. 127) and furnished the funds to print the case, which has been done at the expense of the appellant.

Since the taking of this appeal in March, 1906, six months elapsed before notice of this motion was served and nearly one month more will elapse before it can be heard, when in the ordinary course of events, if we are correctly informed, the hearing upon the merits should ensue within four months more.

POINT I.

This Court has jurisdiction, and a federal question is involved. This motion is not based upon the claim that the Court has not jurisdiction.

Although the appellee does not make this motion on the ground that the Court has no jurisdiction and consequently we are probably not required at this time to substantiate this point, still briefly we cite the following to show there can be no doubt that a federal question is involved and that this Court has jurisdiction.

The decree from which the appeal is taken allowed both of the claims filed by the appellee in full (Fol. 117) and each of these claims is for more than $2,000. By Section 25-b-1 of the Bankruptcy Act, the right to appeal to this Court in such cases is given if the question involved could have been taken on appeal from the highest court of the State to the Supreme Court.

New York Co. Bank vs. Massey, 192 U. S., 138.

This case presents several questions which could have been taken to the Supreme Court from the highest court of the State, to-wit:

1. If the contention of the trustee is sustained the title to these policies still vests in him and we consequently have a question of the title to property under the Bankruptcy Act, which question has been decided adversely to the trustee.

2. It also involves the right of the appellant to parti-

cipate to the extent claimed in the property now in the hands of the trustee, that is, to receive a dividend upon a larger amount than the trustee claims he is entitled to; this also involves a property right under the Bankruptcy Act, which has been decided adversely to the trustee.

3. The litigation involves the construction of Section 57-h of the Bankruptcy Act and the right of the appellant to proceed to a liquidation of security without the order of the Bankruptcy Court; it also involves the construction of Subdivision d of said Section 57.

4. It also involves the right of the appellee to sell these policies pending the receivership and prior to the adjudication, whereas the trustee claims that during that receivership all acts in reference to the bankrupts' property were stayed as matter of law.

POINT II.

No delay has occurred on the part of the appellant. The appellee by neglecting to file its claims for a whole year precluded itself from making this motion on the ground of delay.

There is not a word in the moving papers to show that the appellant has caused any delay in the case, but the record shows that the appeal was taken on the same day on which the findings were prepared by the Circuit Court of Appeals, upon the decree from which

the appeal is taken (Fols. 117 and 120). Also it is true that the record was printed and paid for by the appellant as soon as the funds were requested by the Clerk and that the case is ready for argument as soon as reached.

On the other hand, it appears from the record *that the appellee waited one year, lacking five days, from the date of the adjudication, before it filed its claim*, there being no occasion for doing so. It also appears that the trustee consented to a hearing upon the issues and the issues were heard on the very day on which the amended proofs of claim were filed by the appellee (Fol. 35), and that a decision was rendered immediately. It also appears that since the perfection of this appeal in March, 1906, six months elapsed before notice of this motion to dismiss was served and a month longer will elapse before it will be submitted, making seven months in all, whereas, in the usual course of events not more than four months more should elapse before the hearing upon the merits.

Furthermore, we do not see how the appellee is injured in the meantime. It has the policies which are the source of contention and which the trustee asked to have resold on notice to him, and these policies will not mature until long after this litigation shall have been decided, because Mr. Mertens is still living and even the tontine period in the $50,000 policy, Exhibit G, does not expire until February 15, 1909 (Fol. 67).

POINT III.

The appeal is certainly not frivolous. There are several important and undecided questions which are involved, questions the decision of which will vitally concern the effectiveness of the Bankruptcy Act.

That the appeal is not frivolous would seem to be self-evident from the fact that the *issue in this case has been decided by the lower courts twice in favor of the appellant* as against once in favor of the appellee; that is, the Referee in Bankruptcy and also the District Judge both decided the case in favor of the appellant. This should be sufficient at least to show that there is a debatable question and one which is entitled to argument, as it is not to be presumed that the opinion of the two lower courts was without ground, especially after reading their opinions in the record (pages 21, 23), and also when it is called to mind that whether his decision be right or wrong the District Judge who decided the issue in favor of the appellant, an issue which involves a construction of the Bankruptcy Act, was one of those most prominently identified in Congress with the passage of that Act.

But without attempting to discuss all of the assignments of error, the following questions in the case, none of which has been decided adversely to the appellant by prior decisions of this Court, clearly show that the ap-

peal is not frivolous and that appellant is entitled to be heard on the merits:

A. Between the time of filing the petition and the adjudication, the bankruptcy proceedings themselves were an injunction against any sale of the policies in question. (Oth. cont. of cross.)

It will be remembered that the sale was made on September 14, 1903, the day before the adjudication, and that on August 19, 1903, the bank had actual notice of the proceedings (Tr. 110).

"The filing of the petition was a caveat to all the "world. It was in effect an attachment and injunction. "Thereafter all the property rights of the bankrupt were "ipso facto in abeyance until the final adjudication. "If they were in his favor they revived and were again "in full force. If it were against him, they were entirely "annulled as to him and vested in the assignee for the "purposes of the trust with which he was charged. The "bankruptcy became, as it were, for many purposes, still "the debtor. Thus, the title still in the bankrupt between the filing of the petition and the final adjudication is a title good [illegible] "neither the power of the court or the effect of the final "decree [illegible]"

[illegible]

[illegible]

The last two cases were cited by the District Court in its opinion (p. 26).

In Whitney vs. Wenman, this Court held that a lienor could not even with the consent of a receiver in bankruptcy take property which was subject to the lien; and it would consequently seem impossible for a lienor without the consent or knowledge of the receiver to take such property; but that is what the claimant did in this case.

The appellee attempts to escape these clear holdings of this Court by claiming that the time when the trustee takes title is different than under the former Act. But we claim otherwise, because by Sec. 70-a-5, which appellee wholly ignores, on adjudication the trustee takes title to all property which the bankrupt could have sold prior to the filing of the petition. And this view has been sustained by a decision of equal weight with the decision from which this appeal is taken.

State Bank of Chicago vs. Cox, 143 Fed. R., 91, C. C. A., 7th Circuit.

The two cases of Eyster vs. Gaff and Jerome vs. McCarter, relied upon by appellee are not in point. In the first case, a foreclosure of a real estate mortgage, the action was begun before bankruptcy and the bankrupt was made a party defendant. The sale was conducted under the decree of a competent court and did not occur *until after adjudication.* There is nothing in the reported case to show that the trustee did not have notice of the proceedings. The decision is based on the ground that he did not intervene and become a party which he

might have done, and upon grounds appearing at pages 524 and 525 of the opinion, grounds which are not applicable to the case at bar.

In the second case the appellee seeks to give to the decision much greater breadth than it is entitled to. The action was one for the foreclosure of a mortgage upon real estate. Some of the bonds secured by the mortgage had been pledged and the pledgees had sold them and they had passed to the ownership of innocent third parties. It does not appear as to whether the trustee in bankruptcy had notice of the sale or under what circumstances it was made, but it does appear that the sale was after the adjudication. All that this branch of the case holds is that the Bankruptcy Act did not deprive the pledgee of the right of sale. We do not claim that the Bankruptcy Act does deprive the pledgee of the right of sale, but we do say that his remedy is suspended by that Act, and is made subject to notice to and consent by the Court, which will direct the mode in which it is to be exercised. But there is nothing in the decision which shows what the pledgee must do in exercising that right and furthermore, the sale was not made during the period when, according to the late decisions of this Court, cited in this point, the bankruptcy proceedings would act as a stay. Furthermore, the pledgees still held some of the bonds. As to these, the Court held that they could be proved for the purposes of the foreclosure decree at the full amount, because the Court would see on a distribution of the moneys that they were properly applied. (page 740). And in the case cited there was no receiver

in bankruptcy who, pending the adjudication, was holding the property for the Court.

In other words, the property of the bankrupt, which secured the bonds and without which they were worthless was being administered by the Court, which in making the decision in question said the pledgee's rights would not be finally determined until distribution. But here, where the Court through its receiver had taken constructive possession of the policies, it is inconceivable that the Court, while it was proceeding to hold the estate for all the creditors, could suffer one creditor like the bank, to proceed to administer part of the estate without asking the Court's leave and without notice to it.

B. **The express terms of the promissory notes required the application of the value of the policies and the $6000 deposit on the partnership debt.** (2nd asst. of error.)

It will be remembered that the claim against the individual estate and the claim against the partnership estate are both based upon the same identical notes. The cases holding that collateral furnished by the individual member of a firm need not be applied upon the partnership debt have no applicability to the case at bar because the agreement of the parties provided otherwise.

The policies were held by the bank first, under the terms of the assignments (Fol. 93) which, as they contain no power of sale whatever, are not to be considered because as to them the sale was unquestionably void.

(Opinion of Judge Ray, Fol. 44.) The bank to sustain the sale must rely upon the notes; it does so and claims that the provisions of the notes must be strictly and literally construed.

The notes are all made by the partnership alone with one exception, the one for $2500 which is made by both the partnership and J. M. Mertens. They are all joint and several and are guaranteed (not endorsed) by a joint and several guaranty signed by the partnership and J. M. Mertens, which guaranty by its terms makes all provisions of the face of the notes part of the guaranty itself.

Now the last sentence of the notes which appears on page 4, being part of the very clause assigning the policies and providing for a sale thereof (which appellee claims must be literally enforced) provides that if a sale of the policies be made the proceeds may be applied on the liability *and that the undersigned, J. M. Mertens & Co., "agree to be and remain liable to the said holder for "any deficiency arising upon such sale or sales".* (Fol.8.) We claim this to be an agreement binding on the bank and making it obligatory on the bank to credit the moneys on the partnership as well as the individual debt.

Now as to the $6000 deposit which the bank seized (Fol. 25) and assumed to apply only on the individual claim, the only evidence in regard to this is contained in the proofs of claim. (Fols. 5, 25.) The bank failed to show any agreement under which it was held except the last clause contained in the notes (p. 5), and this clause

provided that any moneys so held should be applied in *"payment and extinguishment* of any obligations or liabilities of the undersigned," that is J. M. Mertens & Co.

Furthermore, as held by the District Court, there was no evidence that the policies did not belong to the partnership (Fol. 44.) The statement in appellee's brief that the trustee admitted that the policies belonged to J. M. Mertens is not correct. See the objections in full.

C. **The sale was a sham and constituted no liquidaton or evidence of the value of the policies. It appeared that they were worth more.** (3rd and 10th assts. of error.)

Appellee cites many cases which are claimed to hold that such a sale as the one in question is valid. But no case has ever held that a pledgee could himself purchase at a private sale held without notice to any one, and none of his citations will bear out such a proposition. These cases are commented on in the latter part of this point.

It will be remembered that no notice of said sale was given to anyone, which must necessarily mean that no one was present at the sale, except said bank's representative; that the bank bid the policies in for itself in Delanoie's name and still holds the policies; that at the time of said sham sale it had actual notice of the appointment of a receiver of the bankrupts.

All of these facts were expressly stipulated. It also appears from those stipulated facts that the sale was con-

ducted under the direction of the bank's attorney, who submits the brief for appellant on this argument; that prior to the sale the bank gave to its attorney the exact amount of money which was bid; that there was but one bid made, which was made by said claimant's attorney in the name of another person, Mr. Delanoie, who was not present at the sale; that the attorney handed the auctioneer the money so given to him, he having bid the exact amount of money which was given to him before the sale; that the attorney received in return from the auctioneer after the sale the same amount which the attorney had paid, less the auctioneer's fees, which amount was paid by a certified check to the order of the claimant.

We submit and intend to argue before the Court that these facts so stipulated were ample justification for and required the findings made by the Referee and the District Court to the effect that the *alleged sale was in fact no sale whatever,* and we ask the Court to read the clear and concise judgment of the Referee at page 21, and the opinion of the District Court at pages 45-47.

Furthermore, and contrary to the finding of the Court below, it appeared that the policies were worth more than was obtained at the alleged sale, because claimants stipulated that Delanoie borrowed shortly after the sale $2622.75 more than he paid for the policies, having previously borrowed the exact amount of his bid immediately after the sale; and from the terms of the $50,000 policy (Fol. 68) it appears that in 1909 the Company will pay for the surrender of that one policy $18823. "and in addition thereto the surplus apportioned by this

Society to this policy." Consequently the Varick Bank bought not a mere chance upon Mr. Mertens' life which, he being a man well along in years, would in case of his death immediately net it $50,000, so far as only one policy is concerned, but it bought a contract under which it was certain to receive in 1909, $18823., plus the surplus. From these provisions of the policies, the Referee was satisfied that they were worth more (Fol. 39.)

The mere fact that the Trustee was in court "for a resale" was sufficient to justify a court of equity in ordering a new sale, because the policies had not passed into the hands of a third person who had purchased at the sale; they were still the property of the Varick Bank and a resale on notice could not possibly hurt it, because it would be under no disadvantage whatever in bidding to the amount of the prior sale, while on the other hand, if a greater bid could be obtained both the claimant and the estate would be benefited to the extent of the extra amount bid.

None of the cases cited by the appellee are authorities which are applicable to the facts here, because it has always been an axiom of the law that it will protect a pledgor from the strict fulfillment of an unconscionable contract of pledge. The cases which appellee cites are all cases where the sale was made in a market, which was always open and which needed no advertisement, such as the New York Stock Exchange, but here we have a security seldom sold, the nature of which was not explained, a sale, of which no one had any notice, where only one bid

was made, a security which needed investigation as to the health, habits, age of the insured and the condition of the Company issuing the same, before a proper bid could be put in by anyone which, in fact, needed advertisement and notice, so that purchasers might have time to prepare themselves. There is not a single case in the books which has ever sustained any pretended sale of a pledge under such conditions as are shown by the stipulated facts, and the statement of the Referee to the effect that it had "no "more significance than it would have had the Varick "Bank in form and with knowledge of the fact that bank-"ruptcy proceedings were pending against its creditors in "which a receiver had been appointed, executed to itself "an absolute assignment of title to the policies."

The two cases cited on page 12 of appellee's brief have no bearing on this issue because in those cases the highest court of the State in which they arose had held the particular lien involved to be valid, whereas no New York court has held that the appellee made a valid sale, and indeed no New York decision in any case ever held such a transaction as this pretended sale valid.

In none of the cases cited on page 13 of appellee's brief, did the pledgee purchase except in Franklin National Bank vs. Newcombe, in which, however, the sale was at public auction, after advertisement, with others present and some other bids (p. 295) and after notice to the pledgor (p. 296). Not a case holds or suggests that a pledgee could himself purchase if the sale be without notice and without advertisement, because such a provision would put the pledgor at an unconscionable disad-

vantage, and would be against public policy which these very cases say would not be allowed.

The word "sale" in such a contract means that there must be some competition or a reasonable endeavor to get a good price. It is perfectly evident that no such effort was made by the appellee.

D. **No liquidation of securities held by a creditor, which is binding upon the Bankruptcy Court, can be made except as directed by the Court. The value of the securities has not been determined.** (4th, 5th and 9th assts. of error.)

Section 57-h of the Bankruptcy Act provides for the allowance of secured claims and the District Court found that the clause therein, "as the Court may direct", modified each method provided for ascertaining the value of the securities, including the case where the securities were to be sold under the terms of the agreement. This interpretation was reversed by the Circuit Court of Appeals, which held virtually that whether it wished to or not, the Bankruptcy Court could not interfere in a liquidation which was made pursuant to the terms of the agreement, even though such liquidation or sale be made after the bankruptcy proceedings had been instituted.

We claim that this decision is directly contrary to the late authority of this Court, namely,

Whitney vs. Wenman, 198 U. S., 539.

Unless the above case be an authority in our favor, it is certain that the question has never been decided by this Court against us, and it will be noted that although this is a motion to dismiss on the ground of frivolity, the appellant's argument under his Points IV and V cites not a single authority and is simply an argument upon the question itself.

But, whether the Court must direct the manner of liquidation or not, certainly the act provides that before having a claim allowed a secured creditor must deduct "the value of securities" held by him (Sec. 57-h.) And certainly the pretended sale under the facts stipulated, with no bidders, no notice, no explanation of the securities, did not show the value, and no court from the facts given could determine the value of the securities. And under Sec. 57-d the referee had the right, as he did, to require evidence of value before allowing the claims.

The clear consequences of upholding this decision would be that any person whose financial circumstances indicated that there could be no relief except by bankruptcy proceedings, could go to any bank or any individual as soon as such circumstances became apparent, that he could obtain a loan from such bank or individual upon a note similar to the notes in question and could pledge with that bank or individual as security therefor his most valuable assets; that after the bankruptcy proceeding was inaugurated, that bank or individual could make a sale of those securities in a manner similar to the pretended sale made by the Varick Bank without notice to the receiver, other creditors, or to any person, and

could bid in those securities at any price which the creditor making the sale saw fit, and that no matter what the equity was the Bankruptcy Court would be absolutely powerless in the premises. Such a construction would be the practical repeal of the provisions of the Bankruptcy Act against preferences. It would entail the grossest waste of the assets of insolvent estates, it would absolutely prevent the courts of bankruptcy from securing a fair and equitable division of the bankrupt's assets.

E. **The burden of proof was upon appellee to establish the value of the policies and to prove its case. It voluntarily assumed the burden of proof.** (8th asst. of error.)

The cases cited by appellee on its brief at page 23, chiefly Whitney vs. Dresser, 200 U. S., 532, are not in point for the reasons that,

1. They were not cases arising upon secured claims, and as the Act requires the application of the security before the claim can be proved, the creditor must necessarily first show the value of the security.

2. Whatever the rule might be in this respect in the first instance, it cannot be invoked by the appellee here, because on the hearing appellee voluntarily chose to proceed and did so by submitting the stipulations of fact.

3. From those stipulations it was clear that the claim was not entitled to allowance as the evidence stood.

No motion for the allowance of the claims was made until these stipulations were put in and upon them, the Trustee, without resting his case, moved for the disallowance of the claims, and the Referee then made his ruling.

But as heretofore shown under our argument at Point C, the value of the policies was not ascertained or shown under the facts submitted, while it did appear that they were worth more than appellee claimed.

F. **The claims should not have been allowed by the Circuit Court of Appeals. At most they should have been sent back to the Referee to hear any evidence the Trustee wished to submit.** (2nd and 7th assts. of error.)

This proposition is supported by a decision of the same Court which made the ruling complained of.

In re Livingston Co., 144 Fed. R., 971.

At folio 84 the Circuit Court of Appeals says: "If the "valuation in this case was unfair, the burden was on the "Trustee to prove the fact." Then the case should be sent back so that the Trustee could have an opportunity. Instead the claims were finally allowed.

Now after the stipulations of fact were submitted by appellee, which was before it asked to have the claims allowed, the Trustee immediately moved thereon without resting his case, for a disallowance, whereupon the ruling of the Referee was made. In the light of that ruling it was unnecessary for the Trustee to give any evidence of

value. To have done so would be equivalent to asking a defendant to give evidence after he had obtained a non-suit on the plaintiff's case; but if a non-suit is reversed it is always with a right to a new hearing, so that the defendant may have a chance to submit his case.

Now the partnership claim, which was on the same indebtedness as the individual claim, was not heard or considered by the Referee (Fol. 40), he holding, "I will re-"serve the question as to the allowance against the co-"partnership for a subsequent determination."

G. **In any event equity should direct a resale.**

This Court under its late decisions has ample power in the premises to equitably administer the right which the bankrupt had at the time when the petition was filed.

Whitney vs. Wenman, 198 U. S., 539.

It could do so in any event, but when, as here, the appellee is coming into court and asking a decree of the Court for an allowance of its claim for a deficiency upon the facts in question, certainly in granting the appellee's petition the Court has the right to say that all equities shall be considered.

Now the trustee asks for a resale of these policies on notice. Such a proceeding cannot possibly be harmful to the claimant, for the policies have not passed into the hands of third parties, making it difficult to get them back. They are still held by the Varick Bank (Fol. 113).

On a resale, no risk would be run by the bank and no damage suffered, because either the policies would bring less or they would bring more. If the bank bought them at a less figure than formerly it would suffer no damage, because it would have the policies and a larger claim against the funds in the hands of the trustee than it now has, and it need not allow the policies to go to a third party for a less sum than previously because it could without damage bid as much again as it did at the former sale. If, on the other hand, the policies brought more at a resale, then the estate would be benefited and the Varick Bank, which would get the additional proceeds, would be benefited; and this would be true in any event, unless the policies on the first sale brought a less price than they were really worth, and if this is true there can be no doubt that a resale should be ordered anyway.

It needs no citation to call to the attention of the Court that equity exercises a wide discretion in opening sales and that courts after long delays frequently reopen sales which are made under advertisement and notice, pursuant to the terms of their own decrees and after judgments of foreclosure with all parties interested have been obtained.

The motion to dismiss the appeal should be denied with costs.

WILL B. CROWLEY,
For Appellant.

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Office Supreme Court, U. S.
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JAMES H. McKENNEY,
CLERK.

SUPREME COURT OF THE UNITED STATES.

ALBERT K. HISCOCK, TRUSTEE IN BANKRUPTCY OF JACOB M. MERTENS, CHARLES R. MERTENS, ERNEST T. MERTENS, AND EDMUND A. MERTENS, INDIVIDUALLY AND AS COMPOSING THE CO-PARTNERSHIP FIRM OF "J. M. MERTENS & CO.," BANKRUPTS,

Appellant,

vs.

THE VARICK BANK OF NEW YORK.

No 244.

BRIEF FOR APPELLANT.

THIS IS AN APPEAL BY ALBERT K. HISCOCK, TRUSTEE IN BANKRUPTCY, FROM A DECREE OF THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, MADE MARCH 22, 1906, WHICH DECREE REVERSED THE DECREE OF THE DISTRICT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF NEW YORK, MADE BY HON. GEORGE W. RAY, DISTRICT JUDGE. THE DIS-

TRICT COURT HAD AFFIRMED THE RULING OF CHARLES L. STONE, REFEREE IN BANKRUPTCY, WHEREBY SAID REFEREE REFUSED TO ALLOW A CLAIM AGAINST THE ESTATE OF J. M. MERTENS INDIVIDUALLY, FILED BY THE APPELLEE, THE VARICK BANK OF NEW YORK, UNTIL FURTHER EVIDENCE BY THE CLAIMANT AS TO THE VALUE OF COLLATERAL HELD BY IT SHOULD BE GIVEN, AND SAID RULING OF THE REFEREE ALSO RESERVED FOR SUBSEQUENT DETERMINATION THE ALLOWANCE OF A CLAIM FILED BY SAID APPELLEE AGAINST THE CO-PARTNERSHIP OF J. M. MERTENS & CO., WHICH CLAIM WAS COMPOSED ALMOST WHOLLY OF THE SAME INDEBTEDNESS AS THAT EMBRACED IN THE CLAIM AGAINST J. M. MERTENS INDIVIDUALLY. THE CIRCUIT COURT OF APPEALS HELD THAT AN ALLEGED SALE OF THE COLLATERAL WITHOUT NOTICE TO THE RECEIVER IN BANKRUPTCY OR TO ANYONE ELSE AND WITHOUT LEAVE OF THE BANKRUPTCY COURT MADE AFTER THE FILING OF THE PETITION AND THE APPOINTMENT OF THE RECEIVER, AT WHICH SALE THE CLAIMANT ITSELF BOUGHT THE COLLATERAL, WAS A SUFFICIENT LIQUIDATION OF THE VALUE THEREOF, AND DIRECTED THE ALLOWANCE IN FULL OF BOTH OF THE CLAIMS AS FILED.

STATEMENT OF THE CASE.

On August 18, 1903, an involuntary petition in bankruptcy was filed against Jacob M. Mertens individually and against the co-partnership of J. M. Mertens & Co., which was composed of him and his sons. On that day Albert K. Hiscock, of Syracuse, N. Y., was appointed the receiver of both of the bankrupt estates. On Sep-

tember 15, 1903, the adjudication in bankruptcy was made and on October 14, 1903, said Albert K. Hiscock was elected and thereafter qualified as trustee. (Page 48).

At the time of the beginning of the bankruptcy proceeding the Varick Bank held five notes aggregating in amount $22,500, four being for $5,000 each and made by J. M. Mertens & Co., and the other being for $2500 and made by J. M. Mertens & Co. and Jacob M. Mertens, all five guaranteed, (not endorsed in the legal sense) by J. M. Mertens & Co. and Jacob M. Mertens, the one for $2500 being also guaranteed by Jennie Mertens, wife of Jacob M. The bank also held some business paper which Mertens & Co. had received from customers and which had been endorsed by the firm and by Jacob M. Mertens. (Pages 4-7). This business paper amounted to about $5,000, but except as it increases the amount of the claim of the bank, it is not particularly material to the legal points under discussion. The five notes above mentioned were all made upon a printed collateral form which appears at page 4 and by them two policies of insurance upon Mr. Mertens' life in the Equitable Life Assurance Society of New York were pledged as security. In some of these five notes, policy No. 252314 was pledged, in some, policy No. 417171 was pledged and in one, both policies were pledged. (Page 6).

Just prior to the expiration of a year subsequent to the adjudication of the bankrupts, in the month of Sep-

tember, 1904, the Varick Bank of New York filed two claims with the Referee in Bankruptcy, Charles L. Stone, of Syracuse, N. Y., against said estates. One claim was for $25489.62 against J. M. Mertens individually, alleging a set off to said amount of $6,000 from a deposit of J. M. Mertens' which was held by the claimant at the time of the bankruptcy proceedings, and also alleging that the claimant held at the time of the filing of the petition in bankruptcy as security and collateral (meaning the life insurance policies aforesaid) property of the bankrupts which was disposed of previous to the adjudication for the sum of $10221. and alleging a balance due from the estate of J. M. Mertens of $9,118.37. (Pages 3-7).

The other claim was for $27,564.47 against the copartnership estate and on the face of the claim was stated to be unsecured. It was for the total amount of all the notes without deduction of any sum. It will be observed carefully, however, that the notes upon which the partnership claim was based are with the exception of about $2400. the identical notes upon which the claim against J. M. Mertens individually was based. (Pages 1-6).

After the filing of these claims and at the first meeting of creditors thereafter at which it could be done, the trustee filed and served objections to both of them. (Pages 15, 16). At the hearing upon these objections, the claimant filed amended proofs of claim, it being agreed that the objections should apply to the amended claims. (Page 19).

The amended proofs of claim are for the same amounts, respectively, but set forth the notes more particularly than the original proofs of claim. It will be noted that the proof of claim against the partnership does not allege that the notes set forth therein and upon which the same were founded have not been paid. It contains the qualified statement "that no part of said debt has been paid by the said J. M. Mertens & Co." (Page 11). The amended proofs of claim also set forth specifically a general description of the collateral which was held for the payment thereof.

These amended proofs of claim allege that *both claims were secured* (Pages 11, 14). So that as to the claim against the partnership we have the original proof which on its face alleges that the claimant had no security for said debt (Page 2), while the amended proof of claim against the partnership alleges that claimant did have collateral security for the payment of said debt, qualifying the statement by alleging that it was deposited by J. M. Mertens individually. However, it will be noted carefully that all of the notes for $22,500, which constitute the bulk of the indebtedness in both claims, on the face thereof describe the insurance policies above and assign the same as security for the payment of said notes, all of which notes and assignments are signed by J. M. Mertens & Co. *So that it at once appeared to the Court from the basis of these claims themselves, namely, from the notes which constitute the chief part of the claims and which on their very face show that the claimant had security for both the individual and partnership*

claims, that that security had been assigned to the claimant by the partnership. (Pages 4-6).

After the proofs of claim and objections were filed as above detailed, the matter came on for hearing before the Referee on December 1, 1904. (Page 18). A stipulation as to sixteen matters of fact was then made. (Pages 19, 20). These stipulations were offered by claimant's attorney, as we hereafter contend, to supplement his proofs.

At this point we will simply call the Court's attention to the important feature that these facts as stipulated disclose that after the filing of the petition in bankruptcy, while the receiver was acting, and on the day before the adjudication, the Varick Bank, without notice to anyone (3d stipulation) placed these policies in the hands of an auctioneer at the real estate auction room in New York City and had him strike them off to the claimant Varick Bank in the name of one Delanoie (11th stipulation) for $10,250, no one else knowing of the sale and no one else bidding, and that at this time the Varick Bank had actual notice of the receivership (14th stipulation). This sale, it will be readily seen, was colorable only and must have been without effect.

After these stipulations, the attorney for the claimant rested without further proof as to the value of the securities and asked for the allowance of the claims, to which the trustee objected. Thereupon the Referee made the ruling which appears at page 21, and in which he says: "I do not think that the sale was a public sale in any fair

"interpretation of that phrase. It appears that the poli-
"cies are still held for the Varick Bank and the transac-
"tion appears to me upon all the concessions here to have
"no more significance than it would have, had the Varick
"Bank in form and with knowledge of the fact that bank-
"ruptcy proceedings were pending against its creditor in
"which a receiver has been appointed, executed to itself
"an absolute assignment of title to the policies." Then after stating that he is not satisfied with this evidence as to value, *the Referee reserved the consideration of the partnership claim, and declined to allow the individual claim on the evidence offered, but expressly gave the appellant the right to submit further evidence thereon.*

The Court will at once see that this ruling did not finally allow or reject the claims or either of them. The claimant asked for a review of this ruling, which was had before the District Court. The Court wrote an opinion thereon (page 23) and by order (page 27) affirmed the ruling of the Referee, *still reserving to the claimant the right to put in further evidence,* which right the claimant has not waived nor stipulated away. Subsequently the Referee, on the motion of counsel for trustee, under the power vested in him by Subdivision h of Section 57 of the Bankruptcy Act, ordered a re-sale of the policies (page 22), but from this order the claimant did not appeal.

The Circuit Court of Appeals, to which the claimant appealed, not only reversed the rulings of the Referee in Bankruptcy and of the District Court, but directed abso-

lutely the allowance of the claims in full as filed. An opinion was written which appears at page 42, and findings were made, which appear at page 48.

From that decision the trustee appealed to this Court and he alleges that the Circuit Court of Appeals committed error in refusing to hold the following propositions:

That the alleged sale was illegal and void:

1st, because the filing of the petition in bankruptcy enjoined the exercise of the power of sale in the interim between the filing of the petition and the adjudication of bankruptcy;

2nd, because the alleged sale, being made without notice, without competition, and the pledgee having become the purchaser, was not a bona fide sale, was a mere sham, was illegal at common law, and could not pass any title to the policies;

3rd, because no sale for the liquidation of the collateral could be held, except as directed and allowed by an order of the Bankruptcy Court.

That by the terms of the promissory notes, as well as by Section 68-a of the Bankruptcy Act and by the law of the application of payments, the $6,000 deposit and offset and any sums realized from the sale of the policies of insurance were required to be applied in reduction of both the partnership and individual claims

and that the claims could be allowed only for the balance; that the partnership claim could not be allowed in full.

That the value of the policies was not determined by said alleged sale and had never been liquidated as required by Section 57-h of the Bankruptcy Act.

That under the stipulated facts the Referee properly found that the policies had a larger value than was obtained on the alleged sale.

That under Section 57-d of the Bankruptcy Act the Referee in his discretion had the right to suspend the allowance of the claims until the value of the collateral had been proved more satisfactorily to him.

That under the stipulated facts the burden of proving that the sale and liquidation of the policies was fair and the fair measure of their value was upon the claimant and not upon the trustee.

That under the stipulated facts the policies were shown to have been furnished by the partnership estate.

That the ruling of the Referee was not a rejection of the claims; that they should not have been finally allowed, but in any event, should have been sent back to the Referee so that the trustee could be heard thereon.

POINT I. A Federal question is involved and the appeal is properly before this Court.

The decree from which the appeal is taken allowed both of the claims filed by the appellee in full (page 66) and each of these claims is for more than $2,000. By Section 25-b-1 of the Bankruptcy Act, the right to appeal to this Court in such cases is given if the question involved could have been taken on appeal from the highest court of the State to the Supreme Court.

New York Co. Bank vs. Massey, 192 U. S., 138.

This case presents several questions which could have been taken to the Supreme Court from the highest court of the State, to-wit:

1. If the contention of the trustee is sustained the title to these policies still vests in him and we consequently have a question of the title to property under the Bankruptcy Act which question has been decided adversly to the trustee.

2. It also involves the right of the appellant to participate to the extent claimed in the property now in the hands of the trustee, that is to receive a dividend upon a larger amount than the trustee claims he is entitled to; this also involves a property right under the Bankruptcy Act, which has been decided adversely to the trustee.

3. The litigation involves the construction of Section 57-h of the Bankruptcy Act and the right of the appellant to proceed to a liquidation of security without the

order of the Bankruptcy Court; it also involves the construction of Section 57-d.

4. It also involves the right of the appellee to sell these policies pending the receivership and prior to the adjudication, whereas the trustee claims that during that receivership all acts in reference to the bankrupts' property were stayed as matter of law.

POINT II. Between the time of filing the petition and the adjudication, the bankruptcy proceedings themselves were an injunction against any sale of the policies in question. After filing the petition, no sale could be held without leave of the Court.

The petition in bankruptcy was filed and a receiver was appointed on August 18, 1903, (page 48) and the adjudication was made September 15, 1903. The alleged sale of these policies, by which the bank claims to have liquidated the value and become the owner thereof, occurred September 14, 1903, the day before the adjudication. This pretended sale was made without leave of the Court and without notice to the receiver, to the bankrupts, or to anyone else (page 63), although the claimant had actual notice that the Court had appointed a receiver. (Page 64).

When the Court appointed the receiver it took into its own constructive possession all of the assets of the bankrupts' estates, including the equities which those estates

had in the policies in question, for their conservation in behalf of the creditors. That such was the policy of the Act, is shown by Subdivision 3 of Section 2, which provides:

> "Appoint receivers or the marshals, upon appli-
> "cation of parties in interest, in case the Courts
> "shall find it absolutely necessary, for the preserva-
> "tion of estates, to take charge of the property of
> "bankrupts after the filing of the petition and until
> "it is dismissed or the trustee is qualified."

And a bankruptcy proceeding is a proceeding *in rem*. *Hanover Nat. Bank vs. Moyses,* 186 U. S., 192.

It has been held by this Court time and time again that a sale of or interference with a bankrupt's property during the interim between the filing of the petition and the adjudication in bankruptcy is void.

"The filing of the petition was a caveat to all the "world. It was in effect an attachment and injunction. "Thereafter all the property rights of the debtor were "*ipso facto* in abeyance until the final adjudication. "If that were in his favor they revived and were again "in full force. If it were against him, they were extin-"guished as to him and vested in the assignee for the "purposes of the trust with which he was charged. The "bankrupt became, as it were, for many purposes, *civili-"ter mortuus.* Those who dealt with his property in the "interval between the filing of the petition and the final "adjudication, did so at their peril. They could limit

"neither the power of the cou t nor the effect of the final "exercise of its jurisdiction.'

Bank vs. Sherman, 101 U. S., 406.

The above doctrine has been sustained by this Court under the present Act in

Whitney vs. Wenman, 198 U. S., 539.
Bryan vs. Bernheimer, 181 U. S., 188.
Mueller vs. Nugent, 184 U. S., 1.

In Whitney vs. Wenman, this Court held that a lienor could not even with the consent of a receiver in bankruptcy take property which was subject to the lien; and it would consequently seem impossible for a lienor without the consent or knowledge of the receiver to take such property; but that is what the claimant did in this case. The Court says in part:

> "In the case of Mueller vs. Nugent, 184 U. S., 1. "this court recognized the power of the bankruptcy "court to compel the surrender of money or other "assets of the bankrupt in his possession *or that of "some one for him.* In that case the decisions in "Bardes vs. Hawarden Bank, White vs. Schloerb "and Bryan vs. Berheimer were reviewed by the "Chief Justice, who delivered the opinion of the "court, and it was held that *the filing of a petition "in bankruptcy is a caveat to all the world, and in "effect an attachment and injunction,* and that on "adjudication title to the bankrupt's estate became "vested in the trustee with actual or constructive "possession, and placed in the custody of the bankruptcy court." (Italics are ours).

The facts in Bryan vs. Bernheimer were as follows: The bankrupt had made a general assignment for the benefit of his creditors nine days before the filing of his petition in bankruptcy and the assignee sold the property after the adjudication in bankruptcy, but before the appointment of a trustee. The bankruptcy court held that the purchaser had no title to the bankrupt's estate.

The claim of appellant made below that some of the above cases are not in point, inasmuch as they do not relate to property held by an adverse claimant, is not well taken as is shown by the opinion in this last case, which says:

> "In the opinion in Bardes vs. Hawarden Bank,
> "178 U. S., 524, 538, it was indeed said: 'The
> " 'powers conferred on the courts of bankruptcy by
> " 'clause 3 of section 2, and by section 69, after the
> " 'filing of a petition in bankruptcy, and in case it
> " 'is necessary for the preservation of property of
> " 'the bankrupt, to authorize receivers or the mar-
> " 'shals to take charge of it until a trustee is ap-
> " 'pointed, can hardly be considered as authorizing
> " 'the forcible seizure of such property in the pos-
> " 'session of an adverse claimant, and have no bear-
> " 'ing upon the question in what courts the trustee
> " 'may sue him.' But the remark, 'can hardly be
> " 'considered as authorizing the forcible seizure of
> " 'such property in the possession of an adverse
> " 'claimant,' was an inadvertence, and upon a ques-
> "tion not arising in the case then before the Court,
> "which related exclusively to jurisdiction of a suit
> "by the trustee after his appointment."

Under the recent decisions of the Court above cited, it is perhaps superfluous, but we cite the following to show the strict adherence of the courts under all circumstances to the principle laid down above.

> "From the time of the filing of the bankrupt's "petition, the property was in the custody of the "Court, and at least, from the time of the appoint- "ment of the assignee, the possession of it by the "bankrupt was, in law, the possession of it by the "assignee. The taking of any of it under the mort- "gage was, after that time, unlawful, and a taking "of it from the custody of this Court, and an officer "thereof."
>
> *In re Rosenberg,* Fed. Cases, No. 12,055. Blatchford, J.

We call the Court's attention to the particularly clear and explicit case *In re* Phelps, Fed. Cases, No. 11,079. In that case the Court held that a mortgagee who proceeded in a State Court after the filing of the petition, with knowledge thereof, to foreclose without the permission of the bankruptcy court, was in contempt and the sale a nullity. By the filing of the petition all property *eo instanti* is in possession of the court. "That all the "estate and property of the bankrupt, and all his right "and title to and interest in the property, whether en- "cumbered or unencumbered, are in custodia legis, and "under the sole and exclusive jurisdiction and control of "the bankruptcy court in which the proceedings are had, "pending the proceedings from the filing of the petition "for adjudication to the close of the proceedings." All

liens are preserved but they "can be enforced only by di-"rection and authority and under the jurisdiction and "control of that court." These propositions "apply "equally to proceedings in the courts and proceedings in "*pais* for the enforcement of liens and other securities, "begun after the commencement of proceedings in bank-"ruptcy."

We also cite

Lee vs. Franklin Sav. Inst., Fed. Cases, No. 8188.
Conner vs. Long, 104 U. S., 244.
McHenry vs. La Societe Francaise, 95 U. S., 60.
Wiswall vs. Sampson, 14 How., 66.
State Bank vs. Cox, 143 Fed. R., 93.
In re Reynolds, 127 Fed. R., 762.
In re Brooks, 91 Fed. R., 509.
In re Antigo, 123 Fed. R., 254.
In re Gutman, 114 Fed. R., 1010.
In re Krinski, 112 Fed. R., 975.

The appellee in the court below sought to escape the force of these clear decisions of this Court by claiming that the rule is now different because the time when the trustee takes title is different than under the former Act. But such an attempt must be futile, in view of the fact that this Court has expressly held otherwise in Mueller vs. Nugent, cited above and quoted from below. Furthermore, by Section 70-a-5, which appellee wholly ignores, on adjudication the trustee takes title to all prop-

erty which the bankrupt could have sold prior to the filing of the petition. We quote the following from

State Bank of Chicago vs. Cox, 143 Fed. R., 91; C. C. A., 7th Circuit.

"The general purposes and scope of bankruptcy "enactments, to take and administer all of the assets "of the bankrupt for pro rata distribution to the "unsecured creditors, is well recognized. In con- "formity with this view the provisions of the pres- "ent act, alike with those of the former acts, are uni- "form—from Section 1, cl. 10 (30 Stat. 544—U. "S. Comp. St. 1901, p. 3418), to and including Sec- "tion 70, cl. 5, in fixing the date when the petition "was filed as the time bankruptcy jurisdiction is es- "tablished over the property then possessed by the "bankrupt, as the date from which the sequestration "of property becomes operative and with reference "to which the validity or invalidity of the various "transactions affecting the estate must be ascer- "tained. As well remarked by Mr. Chief Justice "Fuller,speaking for the Supreme Court,in Mueller "vs. Nugent, 184 U. S., 1, 14, 22 Sup. Ct., 269, 46 "L. Ed. 405:

" 'It is as true of the present law as it was of that " 'of 1867 that the filing of the petition is a caveat " 'to all the world, and in effect an attachment and " 'injunction (Bank vs. Sherman, 101 U. S., 403, " '25 L. Ed. 866), and on adjudication title to the " 'bankrupt's property became vested in the trustee " '(Secs. 70, 21e, 30 Stat. 565, 52 U. S., Comp. St.

" '1901, pp. 3451, 3430), with actual or construc-
" 'tive possession, and placed in the custody of the
" 'bankruptcy court.' "

"In this Court the view is clearly expressed in the "opinion by Judge Jenkins in *In re* Rodgers, 60 C. "C. A., 567, 578, 125 Fed., 169:

" 'The filing of the petition, followed by seizure
" 'and by adjudication in bankruptcy, is a seizure
" 'of the property by the law for the benefit of cred-
" 'itors, and an appropriation of it to the payment
" 'of the debts of the bankrupt. It is a seizure of
" 'the property by legal process, equal in rank to
" 'and of the same force and effect as by execution
" 'or attachment.' "

"In other words, it is the established doctrine that "bankruptcy proceedings are *in rem*, and when com- "menced all of the property then held by the bank- "rupt or for his use (aside from exemptions) is sub- "jected to the jurisdiction of the bankruptcy court, "and that, when bankruptcy is adjudicated, the se- "questration reaches all such property at least, and "becomes operative from the institution of proceed- "ings, as 'a caveat to all the world,' preventing in- "terference by attachments or other means in dero- "gation of the interests of the estate. *In re* Pekin "Plow Co., 50 C. C. A., 257, 259, 112 Fed., 308; "Chesapeake Shoe Co. vs. Seldner, 58 C. C. A., 261, "264, 122 Fed., 593; Loveland's Bankruptcy (2d "Ed.), 366; Collier on Bankruptcy (5th Ed.), 553.

"While title rests in the bankrupt up to adjudica-
"tion, and in form until a trustee qualifies, it is sub-
"ject to the pending sequestration, and no rights can
"be acquired thereunder which are not equally
"amenable. The formal title of the bankrupt to the
"estate passes to the trustee (Section 70-a) 'by
" 'operation of law' as of the date of adjudication,
"but the trustee is vested as well under subdivisions
"(4) and (5) with property transferred in fraud
"of creditors, and 'property which prior to the filing
"of the petition' the bankrupt 'could by any means
"have transferred' or which might have been levied
"upon and sold."

The court below based its decision upon the two cases of Eyster vs. Gaff, 91 U. S., 521, and Jerome vs. McCarter, 94 U. S., 735, but we submit that those cases are not in point.

In the first case, a foreclosure of a real estate mortgage, the action was begun before bankruptcy and the bankrupt was made a party defendant. The sale was conducted under the decree of a competent court and did not occur *until after adjudication. There is nothing in the reported case to show that the trustee did not have notice of the proceedings.* The decision is based on the ground that he did not intervene and become a party which he might have done, and upon grounds appearing at pages 524 and 525 of the opinion, grounds which are not applicable to the case at bar.

In the second case the appellee seeks to give to the de-

cision much greater breadth than it is entitled to. The action was one for the foreclosure of a mortgage upon real estate. Some of the bonds secured by the mortgage had been pledged and the pledgees had sold them and they had passed to the ownership of innocent third parties. *It does not appear as to whether the trustee in bankruptcy had notice of the sale or under what circumstances it was made, but it does appear that the sale was after the adjudication.* All that this branch of the case holds is that the Bankruptcy Act did not deprive the pledgee of the right of sale. We do not claim that the Bankruptcy Act does deprive the pledgee of the right of sale, but we do say that his remedy is suspended by that Act, and is made subject to notice to and consent by the Court, which will direct the mode in which it is to be exercised. But there is nothing in the decision which shows what the pledgee must do in exercising that right and furthermore, the sale was not made during the period when, according to the late decisions of this Court, cited in this point, the bankruptcy proceedings would act as a stay. Furthermore, the pledgees still held some of the bonds. As to these, the Court held that they could be proved for the purposes of the foreclosure decree at the full amount, because the Court would see on a distribution of the moneys that they were properly applied. (Page 740). And in the case cited there was no receiver in bankruptcy who, pending the adjudication, was holding the property for the Court.

In other words, the property of the bankrupt, which secured the bonds and without which they were worthless was being administered by the Court, which in making

the decision in question said the pledgee's rights would not be finally determined until distribution. But here, having through its receiver taken constructive possession of the policies, it is inconceivable that the Court, while proceeding to hold the estate for all the creditors, could suffer one creditor, like the bank, to proceed to administer part of the estate without asking the Court's leave and without notice to it, or its receiver.

That these two cases were not intended to hold that a pledgee could proceed to the sale of a pledge without notice after the institution of a bankruptcy proceeding against the pledgor, also appears from the cases of

McHenry vs. La Societe Francaise, 95 U. S., 60.

Bank vs. Sherman, 101 U. S., 406.

Conner vs. Long, 104 U. S., 229.

These cases were decided immediately after the two cases relied upon by the Court below, the first one at a time when both of the Justices who wrote the opinions in the two cases relied upon below were still members of the Court, and both of them concurred in this subsequent opinion, in which Justice Waite after quoting from Eyster vs. Gaff, said that an assignee may begin proceedings to adjust liens upon the property in his hands, but that " if he does not, the secured creditor who wishes to "make his security available must act; and, *having ob-* "*tained leave of the bankrupt court* to bring his action "for that purpose, he may proceed in the State Court, "&c. * * * Here *the necessary leave to sue was* "*obtained,* &c." (Italics ours).

We submit that this is an explicit holding that leave of the Court is necessary after bankruptcy proceedings are begun before a secured creditor can move.

At the time of the decision of the case of Conner vs. Long, nearly all of the members of the Court which decided the cases relied upon below, were still members of the Court, and the opinion clearly lays down the rule that although a lien be in existence at the time of the filing of a petition in bankruptcy, still a sale thereunder, if made after the filing of the petition, is void, and no title passes to the purchaser.

The Bankruptcy Act would be deprived of all effect if, in the interim, between the filing of the petition and the adjudication, a period when in legal contemplation the bankrupt is, as held in the above cases, *"civiliter mortuus"* and consequently there is no party to represent the interests of the debtor or his creditors, a person holding collateral security could transfer it to himself at his own price, or could, in any manner, even upon notice, dispose of the security.

POINT III. The pretended sale of the insurance policies held as collateral was a sham and was invalid at common law. It constituted no liquidation nor evidence of the value of the policies which, it appeared, were worth more.

After the filing of the objections to the claims, the

claimant voluntarily submitted to the Referee certain facts by way of the stipulations printed at page 19; so that the evidence and exhibits before the Referee in Bankruptcy consisted of the proofs of claim, and original notes upon which the same were based, the insurance policies and the facts which appeared in said stipulations. From these stipulated facts, it appears that on the day before the adjudication in bankruptcy the claimant handed the life insurance policies to its attorney, who on that day handed them to an auctioneer, directing the auctioneer to sell the same at public auction at the New York Real Estate Sales Rooms; that said auctioneer offered them for sale to the highest bidder on said day at said place; *that no notice of said sale was given* to anyone except said Varick Bank; that there was only one bid made which was made by the attorney for the claimant in the sum of $10,250 and in the name of Herbert M. Delanoie, who was not present; that the claimant had instructed said attorney to purchase said policies, if he purchased them, in the name of said Delanoie; that prior to the sale said claimant had given to said attorney the exact amount which was thereafter paid by him for the policies, plus the auctioneer's fees; that immediately thereafter said Delanoie obtained a loan on said policies for the amount of $10,250, and later a further loan for the amount of $2622.75; that at the time of said alleged sale the Varick Bank had actual notice that a receiver in bankruptcy had been appointed; *that said Delanoie acquired title and still holds said policies for said Varick Bank.*

We submit that these facts so stipulated were ample

justification for and required the finding made by the Referee and the District Court, to the effect that the alleged sale was in fact no sale whatever, and we ask the Court to read the clear and concise judgment of the Referee at page 20, and the opinion of the District Court at page 23.

The stipulation that no notice of said sale was given to anyone must necessarily mean that no one was present at the sale except said bank's representative. It was therefore a private sale at which the pledgee became the purchaser at its own price.

The validity of this sale must rest entirely upon the notes and the power of sale contained therein, because the assignments (Exhibits E and F) which were offered in evidence by the claimant (pages 33, 34) contain no power of sale. But we contend that provisions ostensibly authorizing such a sale, are absolutely contrary to public policy so that courts will not allow them to be carried out.

It is the law that a pledgee cannot become the purchaser of pledged securities except by the express permission of the pledgor, and it is also the law that a pledgee is a trustee for the benefit of the pledgor.

"That the pledgee of personal property occupies to-
"ward the pledgor somewhat of a fiduciary relation, by
"virtue of which, he being a trustee to sell, it becomes his
"duty to exercise his right of sale for the benefit of the
"pledgor."

Pauly vs. State Loan Co., 165 U. S., 620.
(Justice Harlan).

"By virtue of the pledge, the pledgee has the right by "law, on the default of the pledgor, to sell the property "pledged in satisfaction of the pledgor's obligation. As "in that transaction the pledgee is the vendor, he cannot "also be the vendee. In reference to the pledge and to "the pledgor, he occupies a fiduciary relation, by virtue "of which it becomes his duty to exercise his right of sale "for the benefit of the pledgor. He is in the position of "a trustee to sell, and is by a familiar maxim of equity "forbidden to purchase for his own use at his own sale."

Easton vs. German American Bank, 127 U. S., 537.

"Trustees and mortgagees, in the execution of their "powers, must use the utmost good faith toward all par- "ties in interest. This proposition cannot be too strongly "stated and enforced. They must act impartially for "every person who has any rights in the estate. * * * "They must use every effort to sell the estate under every "must exercise every discretion, so far as they have any, "possible advantage of time, place and publicity. They "in an intelligent and reasonable manner."

"They are scrutinized by courts with great care and "will not be sustained unless conducted with all fairness, "regularity and scrupulous integrity. * * * If "proper notices of the sale are not given, or if the pro- "ceedings are in any way contrary to justice and equity, "the sale will not be allowed to stand."

Perry on Trusts, 4th Ed., Sec. 602, o. x.

Such being the case it is absolutely impossible for a

pledgee to perform his duty to the pledgor at a private sale which is without notice and therefore without competition, which he conducts himself and at which he becomes the purchaser. It is a trait of human nature to wish to buy as cheaply as possible; that motive is in direct conflict with the pledgee's duty to the pledgor to make the property bring as much as possible; but the pledgee is both purchaser and seller and his interest on the one hand is diametrically opposed to his interest on the other. The law contains no instance where duty and interest are allowed to come into such a conflict. It is impossible in equity to allow the right to sell at private sale and the right to purchase to be joined together.

This was held to be the law in

Laclede Nat. Bank vs. Richardson, 156 Mo., 275. (Approved in *Jones on Pledges*, Sec. 635-a).

Certain promissory notes secured by mortgages on real estate were pledged by means of a collateral note similar to the notes in question here, providing that the pledgee might sell at public or private sale without notice and might itself become the purchaser. A sale was made after an advertisement thereof had been given. The Court held that although authorized to sell at public or private sale without notice and to purchase, still, "that "the bank held these securities in trust is undoubted. It, "therefore, became the imperative duty of the bank in ex- "ercising the rights conferred by the power of sale con- "tained in the collateral notes, to use the utmost good "faith."

"The trust relation occupied by the bank toward the "pledgor made it incumbent upon the former to obtain "the best possible price and to use every reasonable "means to obtain the full value of the pledged property. "The condition of the weather and the absence of any "considerable number of bidders, rendered an adjourn- "ment necessary in order to prevent a sacrifice of the se- "curities." The Court continues and holds that on account of the nature of the securities, time should be given and a long advertisement made, so that intending purchasers might look up the notes and the character of the securities furnished by the mortgages.

This language is particularly applicable to the securities in the case at bar, which certainly needed investigation before anyone could intelligently bid upon them. (See Judge Ray's opinion, page 25).

The above case also quotes the following case in which notes with similar provisions existed:

Dana vs. Buckeye C. & C. Co., 38 Ill. App., 371.

"It is an authority to sell at public or private sale, but "creditors in whom such authority is vested, cannot exer- "cise it otherwise than under a trust for other creditors' "benefit, as well as their own. * * * That a per- "son holding property upon securities in pledge, occupies "the relation of trustee for the owner, and as such, in the "absence of special power to do otherwise, is bound to "proceed as a prudent owner would do with his own."

Wherever courts have allowed a pledgee to bid, he has not been allowed to conduct the sale.

Jones on Pledges, Sec. 648.

Clauses inserted in the contracts of pledge providing that if the terms of the contract are not strictly fulfilled the pledge shall not be redeemable, have always been held of no avail, for the common law terms such a stipulation unconscionable and void upon the ground of public policy as tending to the oppression of the debtor.

Story on Bailments, Sec. 318-345.

If the power of sale in the notes in question is to be upheld and construed strictly in their broadest terms in favor of the pledgee, as is sought to be done here, then it is tatamount to depriving the pledgee of the right to redeem.

The Court below and the appellee in its behalf, sought to meet this proposition by citing a number of cases, the chief of which are Toplitz vs. Bauer and Baker vs. Drake.

But these authorities do not go to the extent claimed because while holding that a pledgee may stipulate for a sale without notice, they all make the important exception that he cannot make stipulations which are *"in contravention of a statute, against public policy or fraudulent."* This exception made in the authorities which the appellee relies upon seems clearly to cover this case.

None of the cases cited by the appellee are authorities

which are applicable to the facts here, because it has always been an axiom of the law that it will protect a pledgor from the strict fulfillment of an unconscionable contract of pledge. The cases which appellee cites are all cases where the sale was made in a market, which was always open and which needed no advertisement, such as the New York Stock Exchange, but here we have a security seldom sold, the nature of which was not explained, a sale of which no one had any notice, where only one bid was made, a security which needed investigation as to the health, habits, age of the insured and the condition of the company issuing the same, before a proper bid could be put in by anyone, a sale which, in fact, needed advertisement and notice, so that purchasers might have time to prepare themselves. There is not a single case in the books which has ever sustained any pretended sale of a pledge under such conditions as are shown by the stipulated facts, and the statement of the Referee to the effect that it had "no more significance than it "would have had the Varick Bank in form and with "knowledge of the fact that bankruptcy proceedings were "pending against its creditors in which a receiver had "been appointed, executed to itself an absolute assignment of title to the policies," is peculiarly applicable.

In none of the cases cited in appellee's brief below, did the pledgee purchase except in Franklin National Bank vs. Newcombe, in which, however, the sale was at public auction, after advertisement, with others present and some other bids (page 295) and after notice to the pledgor (p. 296), and except in the case of Fidelity In-

surance Co. vs. Roanoke, where the sale was of bonds, but was made at a stock exchange, that is, at a place especially devoted to the sale and purchase of securities and which from its very nature secured such competition as is ordinarily secured only by advertisement and notice.

Not a case holds or suggests that a pledgee could himself purchase if the sale be without notice and without advertisement, because such a provision would put the pledgor at an unconscionable disadvantage, and would be against public policy which these very cases say would not be allowed.

The word "sale" in such a contract means that there must be some competition or a reasonable endeavor to get a good price. It is perfectly evident that no such effort was made by the appellee.

Furthermore, and contrary to the finding of the Court below, it appeared that the policies were worth more than was obtained at the alleged sale, because claimants stipulated that Delanoie borrowed shortly after the sale $2622.75 more than he paid for the policies, having previously borrowed the exact amount of his bid immediately after the sale; and from the terms of the $50,000 policy (page. 36) it appears that in 1909 the company will pay for the surrender of that one policy $18823. "and in addition thereto the surplus apportioned by this "Society to this policy." Consequently the Varick Bank bought not a mere chance upon Mr. Mertens' life which,

he being a man well along in years, would in case of his death immediately net it $50,000, so far as only one policy is concerned, but it bought a contract under which it was certain to receive in 1909, $18823., plus the surplus. From these provisions of the policies, the Referee was satisfied that they were worth more. (Page 21).

The attention of the Court is called to the case arising in this same bankruptcy proceeding recently argued before this Court as No. 209 on the present calendar. A reference to that record, at page 24, will show that that case was tried before the same referee in bankruptcy, that this identical policy No. 417171 for $50,000 was involved, and that the testimony there given shows that it was worth at least $12000, or $5000 more than the claimant gave. The referee, of course, had this in mind, and he was familiar with the value of "the surplus" to be apportioned to policies of this nature.

A proceeding in bankruptcy is one proceeding, and he had a right to give that evidence consideration herein.

POINT IV. The $6000 deposit and the value of the policies should also be applied in reduction of the amount of the partnership claim. The express terms of the promissory notes so require. It did not appear that the policies belonged to J. M. Mertens.

If the Court should hold the alleged sale of the policies invalid, still it is important that a ruling be made by the

Court upon this point, inasmuch as the same question might arise after a proper re-sale of the policies.

Keeping in mind that the claim against the individual estate and the claim against the partnership estate are both based upon the same identical notes, we contend that the above proposition is correct for the following reasons:

AS TO THE $6,000 OFFSET.

It appears from the proofs of claim (pages 3 and 14) that the Varick Bank held $6,000 on deposit, which it assumed to apply on the individual claim without reducing the partnership claim. In the proofs of claim against the individual estate, both the original and amended, it is alleged, "That there are "no offsets or counterclaims to the same, except the sum "of six thousand ($6,000) dollars, held by said Varick "Bank of New York on deposit and as collateral security "at the time of the filing of the petition herein." Except for these allegations in the proofs of claim and the allegation on page 11 in the partnership claim that this sum was held for the individual account of J. M. Mertens, there is no evidence of any kind to show the terms or conditions upon which this money was deposited. Therefore the entire case, so far as the $6,000 is concerned, rests upon the allegations above set forth and upon the terms of the promissory notes which were produced before the Referee and were a part of the proofs of claim.

Such being the fact, it is evident that the $6,000 must

be applied in reduction of both the individual and the partnership claims for the following reasons:

1st. Each of the five collateral notes, aggregating $22,500, and composing the principal part of each claim, provided: "The undersigned do hereby authorize and "empower the said bank, (but no other holder) at its op- "tion, at any time, to appropriate and apply to the *pay- "ment and extinguishment of any obligations or liabili- "ties of the undersigned to it*, whether now existing or "hereafter contracted, any and all moneys now or here- "after in the hands of the said bank, on deposit or other- "wise, to the credit of or belonging to the undersigned, "whether the said obligations or liabilities are then due "or not due." (Page 5, italics ours). These notes are all signed by J. M. Mertens & Co., and the one for $2500, dated September 6, 1903, is also signed by J. M. Mertens. Each of these notes has also a guaranty printed upon the back and all of those guarantys are signed by the partnership and by J. M. Mertens individually, and the guaranty on the one for $2500 above mentioned, is also signed by Jennie Mertens. Each of these guarantys expressly assents to the terms and conditions upon the face of the notes, so that by the terms of these notes and guarantys, not only Mertens & Co., but J. M. Mertens contracted and stipulated that any moneys on deposit to the order of them or either of them, should be applied upon the *payment and extinguishment of the obligations of the undersigned," i. e., J. M. Mertens & Co.*, and the Varick Bank assented, and accepted said notes upon these terms. Certainly, such is the case if the Varick Bank in seizing this $6,000 acted upon the contract right

given it under the terms of the notes which are the only agreements relating to the $6,000.

2nd. If, on the other hand, the Varick Bank says that it did not act under the terms and conditions of the notes, but relied upon its naked legal right of offset, then in seizing this $6,000 it brought itself within Section 68-a of the Bankruptcy Act, which provides as follows:

> "In all cases of mutual debts or mutual credits "between the estate of a bankrupt and a creditor the "account shall be stated and one debt shall be set off "against the other, *and the balance only shall be "allowed* or paid." (Italics ours).

If the bank waived the terms of the notes and relied upon its legal rights to offset this deposit, then the time when the setoff was required to be made was at the time of the filing of the petition.

Collier on Bankruptcy, 4th Ed., 496.
In re City Bank, Fed. Cases, 2742.
Drake vs. Rollo, Fed. Cases, 4066.

Now, at the time of the filing of the petition, only two of the notes in the partnership claim were due, being the first two set forth in the tabulation on page 5, amounting to $700.90, and none of the notes in the individual claim were due. Under the law relating to the application of payments, as hereinafter cited, the bank would be compelled to apply this $6,000 upon the notes first due, which would *extinguish in toto* $6,000 of the notes and which would of course include the notes embraced

within the partnership claim, because there are none in the individual claim which are not also in the partnership claim. After such extinguishment, certainly no claim for a dividend from either partnership or individual assets could be legally proved by the Varick Bank.

AS TO THE PROCEEDS FROM THE POLICIES.

In case the Court should hold that the so-called sale of the policies which netted $10,250 was a valid sale and liquidation of that collateral, then it is also respectfully submitted that the proceeds of these policies were required to be applied in extinguishment of any indebtedness against the partnership, as well as against the individual estate, for the following reasons:

1. These policies were held by the Varick Bank under and by virtue of two assignments (pages 33, 34), and also under and by virtue of the terms of the five collateral promissory notes aggregating $22,500; but inasmuch as the assignments contain no power of sale whatever, the bank in selling the policies must have acted by virtue of the provisions of the promissory notes. Having acted under the terms prescribed by the notes, it became bound as to all things relating to said sale, including the application of the proceeds thereof, to observe the terms and conditions provided by said notes; the bank seeks to sustain this sale by asserting that the provisions thereof must be strictly and literally construed. It cannot insist upon some of these terms being strictly observed unless the others are strictly observed.

These notes, as above mentioned, aggregating $22,500, are five in number and all are signed by J. M. Mertens & Company, except the one for $2500, which is also signed by J. M. Mertens. On the back of each is a guaranty which is also signed by the partnership and by J. M. Mertens, the one for $2500 being also signed by Jennie Mertens. This guaranty, by its terms, assented to all of the provisions on the face of the notes.

Now, these notes on their face each contain this clause: "In case of sale for any cause, after deducting all costs "and expenses of every kind for collection, sale or de- "livery, the said holder may apply the residue of the pro- "ceeds of the sale or sales so made, *to pay* one or more or "all of the said liabilities to it or him as to it or him shall "seem proper, whether then due or not due, making "proper rebate for interest on liabilities not then due, "and returning the overplus, if any, *to the undersigned, "who agree to be and remain liable to the said holder for "any deficiency arising upon such sale or sales.*" (Italics ours).

We maintain that unquestionably this was and is a clear and express contract to which the bank, by accepting the notes and acting upon this power of sale contained therein, became a party and which bound it to the proposition that in case of a sale of the policies, not only J. M. Mertens & Company, who were the "undersigned" but also J. M. Mertens, were to remain liable only for *the deficiency* which remained after the application of the proceeds of the sale upon said notes; and that consequently the Varick Bank could have no claim against

the partnership for any amount greater than would be left after the application of the proceeds of that sale. The word "undersigned" in the clause, "The under-"signed, who agree to be and remain liable to the said "holder for any deficiency arising upon such sale or "sales," referred certainly to J. M. Mertens & Company, who were the only makers of four of these notes, J. M. Mertens being the only other maker upon any note and he only upon the one amounting to $2500.

2. Furthermore, at the time of the so-called sale, September 14, and also at the time of the adjudication which was but one day later, there was due on the partnership liability only the first ten notes set forth in the schedules at page 5, which aggregate in amount $13,530.47; and of the notes comprised in the individual liability set forth in the schedules at page 6, only the first five, aggregating in amount $11,738.54 were due; so that applying upon this indebtedness the $6,000 on deposit and the $173.21 also on deposit, which was applied upon the partnership debt (page 3) and the amount obtained from the so-called sale of $10,250, we have more than enough to *pay in full all the liabilities which were due at that time,* and leave a surplus as to the partnership claim of nearly $3,000, and as to the individual claim of nearly $5,000, for application upon the liability next becoming due.

While there are cases (but none in this Court) which hold that a creditor having a claim against a maker and also against an endorser or surety for the payment of a note, may prove his claim in full against either or both

parties without applying *any partial payments* made by either, still there is not an authority which holds that after the claimant has received moneys sufficient to *pay in full* his obligation, no matter whether said moneys come from the maker or from the endorser, he can prove his claim for any amount against the other. A payment in full of an obligation, whether made by the endorser or by some one else, must *absolutely extinguish it*, and thereafter no claim can be based thereon by the parties holding it.

The moneys received from the $6,000 deposit and the proceeds of the policies must have been applied in one of these two ways:

a. The Varick Bank must have made the application under the terms of the notes which, as shown above, stipulate for the entire extinguishment of the obligations, so far as those proceeds would go.

b. If the Varick Bank did not rely upon the terms of the notes, then the seizing of these moneys, both the deposit of $6,000 and the proceeds of the policies, was a payment involuntarily made by the debtor. The bank could therefore make no application of the proceeds, but it was left for the law to make the application.

Blackstone Bank vs. Hill, 10 Pick., 129.
Cage vs. Iler, 13 Miss., 410.
U. S. vs. Kirkpatrick, 9 Wheaton, 720.
Cowperthwaite vs. Sheffield, 1 Sandford, 416-453.
Larrabee vs. Lumbert, 32 Maine, 97.

If the law is to make the application, then it will make it upon those obligations first becoming due and will therefore completely extinguish and wipe out the notes first due, which in this case means it will extinguish all except the last three notes of the partnership claim.

"The law will not apply money received to the pay-
"ment of a debt not due, nor can such an application be
"made, except by express agreement of the parties."

Farwell vs. Importers' Bank, 90 N. Y., 490.

"In other words, each item of payment or credit is ap-
"plied in extinguishment of the earliest items of debt,
"until it is exhausted. This was the rule laid down in
"Clayton's case (1 Merivale R., 572, 604, 608); and it
"was recognized and acted upon by the Supreme Court
"of the United States, in U. S. vs. Kirkpatrick (9
"Wheaton R., 720, 737, 738); and by this Court in U.
"S. vs. Wardwell (5 Mason R., 82-87). In McDonnell
"vs. The Blackstone Canal Company (5 Mason R., 11),
"the doctrine was limited to debts antecedently due, and
"not applied to debts which were not due at the time of
"the payments or credits. This qualification is indis-
"pensable to the good sense of the rule, which is founded
"upon the apparent intentions of the parties; for it
"would be almost absurd to suppose that a man, owing to
"his creditor two debts, one of which was due, and the
"other not, should be presumed to intend to apply pay-
"ments, made to his creditor, in discharge of the debt not
"yet due, rather than to the debt actually due."

Gass vs. Stinson, 3 Sumner, 112.

The following is a case where, although the creditor had the right to apply the proceeds of collateral to present or future indebtedness, the Court held that the law would make the application on the earliest items.

Thompson vs. St. Nicholas Bank, 113 N. Y., 333.

In equity a general payment will be applied to the earliest items of indebtedness, though the creditor may hold security for that and not for the residue.

Truscott vs. King, 6 N. Y., 147.
U. S. vs. Kirkpatrick, 9 Wheaton, 720.
Nat. Park Bank vs. Seaboard Bank, 114 N. Y., 28.
Pond vs. Harwood, 139 N. Y., 125.
Larrabee vs. Lumbert, 32 Maine, 97.

Certainly there could be no equity in allowing the Varick Bank to so apply these payments that having obtained much more than would satisfy in full a majority of the demands, it could still claim that so far as the partnership debt went, the whole remained unpaid.

3. Under the facts of this case, we submit that the cases cited by the Court below as authorities for the allowance of the partnership claim in full without deduction of the proceeds of the policies, on the ground that being on the life of J. M. Mertens they were individual assets, are not in point and have no application to this case.

Those cases all relate to a security pledged or given by

the individual and received by the creditor from the individual to secure the individual's liability upon the indebtedness.

Here all the notes except the one for $2500 which was also signed by J. M. Mertens, but which was not due when the sale was made, were signed by the firm, which was the only maker thereof. Those notes contain specific assignments of the policies in question, which assignments were made by J. M. Mertens & Co.

The face of the obligations show that J. M. Mertens & Co. were putting up and pledging these policies and that the Varick Bank was accepting them from the firm of J. M. Mertens & Co., and not from J. M. Mertens. Consequently, the Varick Bank, although the policies were upon the life of J. M. Mertens, received, as shown by the notes in question, these policies from the firm and accepted them from the firm and sold them under an assignment and power of sale given by the firm. The policies were not put up by J. M. Mertens to secure his guaranty or his individual obligation, but they were at the outset pledged by and received from the firm to secure the debt of the firm. The notes show that the partnership had them, the partnership pledged them, the debtor received them from the partnership and stipulated and agreed to apply the proceeds upon the partnership debt, and J. M. Mertens, if he ever had any interest in the policies, by his adoption of the terms of these notes and the assignments by the firm therein contained, as shown by his guaranty, consented to the pledging of the policies by the

firm. Consequently, it must be assumed, even if the policies were upon the life of J. M. Mertens, that they had been taken out by the firm, or at least had become the firm's property and belonged to it.

This makes a much different case than where, by agreement, separate and distinct from the evidence of indebtedness by a firm, a partner puts up his individual assets. And the cases cited below, both in the opinion of the Court and by the appellee, are not applicable. Here we have a case where the very agreement upon which the indebtedness is made and which is made by the firm also pledges this property for the security thereof.

We further submit that under the facts above set forth it was error for the Court below to hold that the mere circumstance that J. M. Mertens' life was insured by the policy was evidence that it belonged to him. Such evidence, if it amounted to anything, was overcome and negatived by the fact that the notes which were made by J. M. Mertens & Co., which pledged these policies and contained the power of sale which was acted upon by the claimant, were made by J. M. Mertens & Co.

POINT V. No liquidation of securities which is binding upon the Bankruptcy Court, can be made by a creditor except as directed by the Court. The "value" of the securities was not determined and the Referee had the right under Section 57-d to refuse to be bound by the alleged sale.

Section 57-h of the Bankruptcy Act provides:

> "The value of securities held by secured creditors "shall be determined by converting the same into "money according to the terms of the agreement "pursuant to which such securities were delivered to "such creditors or by such creditors and the trustee "by agreement, arbitration, compromise, or litiga- "tion, as the court may direct, and the amount of "such value shall be credited upon such claims, and "a dividend shall be paid only on the unpaid bal- "ance."

The District Court held that the clause therein, "as "the Court may direct," modifies each method provided for ascertaining the value of the securities, including the case where the securities were to be sold under the terms of the agreement. This interpretation was reversed by the Circuit Court of Appeals, which held virtually that whether it wished to or not, the Bankruptcy Court could not intertere in a liquidation which was made pursuant to the terms of the agreement, even though such liquidation or sale be made after the bankruptcy proceedings have been instituted.

We claim that this decision is directly contrary to the late authority of this Court, namely,

Whitney vs. Wenman, 198 U. S., 539.

The goods in the case cited were seized pursuant to the terms of the agreement, but this Court did not hesitate to declare the seizure illegal, although the seizure was made with the assent of the receiver in bankruptcy.

It is quite essential, as we maintain, to the carrying out of the general scope and provisions of the Bankruptcy Act for the Court to follow the interpretation given to this section by Judge Ray and to hold that the words, "as the Court may direct," relate to every form of liquidation. Otherwise preferences can be easily accomplished.

Aside from the provisions of the statute, however, as a matter of practice, it was necessary for the appellee to have obtained the consent of the Court to the sale. Upon this point we cite

McHenry vs. Societe Francaise, 95 U. S., 60,

where the Court, speaking of the liquidation of securities, says:

"If he does not, the secured creditor, who wishes to "make his security available, must act; and having ob- "tained leave of the bankrupt court to bring his action "for that purpose, he may proceed in the State Court," &c. * * * "Here the necessary leave to sue was "obtained before the decree was rendered," &c.

But whether the Court must direct the manner of liquidation or not, certainly the act provides that before having a claim allowed a secured creditor must deduct *"the value of securities"* held by him (Sec. 57-h.) And certainly the pretended sale under the facts stipulated, with no bidders, no notice, no explanation of the securities, did not show *the value,* and no court from the facts given could determine the value of the securities.

The Referee had some discretion; he had a conscience to satisfy; he was required to ascertain the value and deduct it, and Section 57-d, which provides that the consideration of claims may "be continued for cause by the "Court upon its own motion," was ample authority for him to require further evidence of the value of the policies before allowing the claims.

This Court has recently held that this power can be exercised.

Whitney vs. Dresser, 200 U. S., 536.

The Court says: "Justice is secured by the power to "continue the consideration of a claim wherever it ap- "pears there is a good reason for it."

The clear consequences of upholding the decision below would be that any person whose financial circumstances indicated that there could be no relief except by bankruptcy proceedings, could go to any bank or any individual as soon as such circumstances became apparent, that he could obtain a loan from such bank or individual upon a note similar to the notes in question and could

pledge with that bank or individual as security therefor his most valuable assets; that after the bankruptcy proceeding was inaugurated, that bank or individual could make a sale of those securities in a manner similar to the pretended sale made by the Varick Bank without notice to the receiver, other creditors, or to any person, and could bid in those securities at any price which the creditor making the sale saw fit, and that no matter what the equity was, the Bankruptcy Court would be absolutely powerless in the premises. Such a construction would be the practical repeal of the provisions of the Bankruptcy Act against preferences. It would entail the grossest waste of the assets of insolvent estates, it would absolutely prevent the courts of bankruptcy from securing a fair and equitable division of the bankrupt's assets.

POINT VI. The burden of proof was upon appellee to establish the value of the policies and to prove its case. It voluntarily assumed the burden of proof.

The cases cited by appellee on its brief below, chiefly Whitney vs. Dresser, 200 U. S., 532, are not in point for the reasons that,

1. They were not cases arising upon secured claims, and as the Act requires the application of the security before the claim can be proved, the creditor must necessarily first show the value of the security.

Bankruptcy Act, Sec. 57-h.

2. Whatever the rule might be in this respect in the first instance, it cannot be invoked by the appellee here, because on the hearing appellee voluntarily chose to proceed and did so by submitting the stipulations of fact.

That the appellee itself submitted stipulations of fact and that it did not consider a case made out for the allowance of its claims until after those stipulations had been submitted, is conclusively shown by the fact that he did not ask the Court to allow his claims or to hold that the burden of proceeding was on the trustee *until after* those facts were stipulated, and by the fact that he then asked the trustee's attorney to state whether the trustee rested his case under the objections. If the stipulations had been offered as part of the trustee's case, the question asked would have been as to whether he rested his case under the *objections and stipulations of fact.* (Page 21).

No motion for the allowance of the claims was made until these stipulations were put in and upon them, the trustee, without resting his case, moved for the disallowance of the claims, and the Referee then made his ruling.

3. Those stipulations showed that the bank being in a trust relation toward the pledgor had itself purchased the property which was the subject of the pledge or trust. By so doing the bank became subject to the familiar rule that the burden of proof is upon the trustee who acquires the trust property, to show that his title is unimpeachable. In this case the burden was upon the bank to show that the sale of the policies and the price obtained therefor was fair. This the stipulations did not do.

4. From those stipulations, it was clear that the claim was not entitled to allowance, as the evidence stood, because there was no adequate evidence of value. Whatever evidence there was on this point was to the effect that the policies were worth more than the appellee claimed. The Referee was not satisfied with the evidence of value, and he had a right to require further evidence under the very authority which appellee cites, Whitney vs. Dresser, where the Court says: "Justice is "secured by the power to continue the consideration of a "claim whenever it appears there is good reason for it."

5. The original partnership proof of claim did not conform to the form prescribed by the Supreme Court. It alleged at the end that the bank had not received any security for said debt whatever, but qualified it by saying "from the said J. M. Mertens & Co." The amended partnership proof did not allege unqualifiedly that no part of said debt had not been paid, but qualified it by saying "by the said J. M. Mertens & Co.", and it alleged that the bank did have security for the debt but that the same was deposited by J. M. Mertens, whereas the notes, which were part of the claim, purported to show that J. M. Mertens & Co. in fact had pledged the securities; in other words, the claims taken together, individual and partnership, showed that they were contradictory; also it was not apparent to the Referee but that a sale of the securities properly made would be enough to cancel the partnership claim in full.

POINT VII. The claims should not have been allowed by the Circuit Court of Appeals. At most they should have been sent back to the Referee to hear any evidence the Trustee wished to submit.

This proposition is supported by a decision of the same Court which made the ruling complained of.

In re Livingston Co., 144 Fed. R., 971.

At page 46 the Circuit Court of Appeals says: "If "the valuation in this case was unfair, the burden was on "the Trustee to prove the fact." Then the case should be sent back so that the Trustee could have an opportunity. Instead the claims were finally allowed.

After the stipulations of fact were submitted by appellee, which was before it asked to have the claims allowed, the Trustee immediately moved thereon without resting his case, for a disallowance, whereupon the ruling of the Referee was made. In the light of that ruling it was unnecessary for the Trustee to give any evidence of value. To have done so would be equivalent to asking a defendant to give evidence after he had obtained a non-suit on the plaintiff's case; but if a non-suit is reversed it is always with a right to a new hearing, so that the defendant may have a chance to submit his case.

The partnership claim, which was on the same indebtedness as the individual claim, was not heard or considered by the Referee (page 21), he holding, "I will "reserve the question as to the allowance against the co-"partnership for a subsequent determination."

But this ruling was made with the express privilege to the claimant to submit further evidence (page 22) and the order of the District Court also gave this privilege to the appellee (page 27). With such a privilege given to the claimant, it is certainly unjust to deprive the trustee, as the decree below does, of the right to give evidence, he having had no opportunity to do so, and having had no opportunity to present the questions involved.

POINT VIII. In any event equity should direct a resale.

This Court under its late decisions has ample power in the premises to equitably administer the right which the bankrupt had at the time when the petition was filed.

Whitney vs. Wenman, 198 U. S., 539.

It could do so in any event, but when, as here, the appellee is coming into court and asking a decree of the Court for an allowance of its claim for a deficiency upon the facts in question, certainly in granting the appellee's petition the Court has the right to say that all equities shall be considered.

Now the trustee asks for a resale of these policies on notice. Such a proceeding cannot possibly be harmful to the claimant, for the policies have not passed into the hands of third parties, making it difficult to get them back. They are still held by the Varick Bank. (Page 64).

On a resale, no risk would be run by the bank and no damage suffered, because either the policies would bring less or they would bring more. If the bank bought them at a less figure than formerly it would suffer no damage, because it would have the policies and a larger claim against the funds in the hands of the trustee than it now has, and it need not allow the policies to go to a third party for a less sum than previously because it could without damage bid as much again as it did at the former sale. If, on the other hand, the policies brought more at a resale, then the estate would be benefited and the Varick Bank, which would get the additional proceeds, would be benefited; and this would be true in any event, unless the policies on the first sale brought a less price than they were really worth, and if this is true there can be no doubt that a resale should be ordered anyway.

It needs no citation to call to the attention of the Court that equity exercises a wide discretion in opening sales and that courts after long delays frequently reopen sales which are made under advertisement and notice, pursuant to the terms of their own decrees and after judgments of foreclosure with all parties interested have been obtained.

The alleged sale should be declared void; a new sale should be ordered upon notice to the trustee; the $6,000 deposit and the sums to be obtained from the policies should be required to be applied upon both claims in reduction of the amounts thereof; the decree of the Circuit Court of Appeals should be reversed and the decree of

the District Court affirmed with costs and such penalties for the unfair attitude of the claimant and the delay occasioned thereby as to the Court seems just; with the foregoing instructions the claims and cause should be remanded to the District Court to hear the other issues raised by the objections and to proceed accordingly.

All of which is respectfully submitted.

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